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March 14, 2002

BY HAND

Mr. Kenneth Schagrin
Office of the United States Trade Representative
600 17th Street, N.W.
Washington, DC 20508

Re: Update and Re-Submission of 2001 White Paper on Australia; Section 1377 Review

Dear Mr. Schagrin:

On September 17, 2001, Swidler Berlin Shereff Friedman, LLP ("SBSF"), submitted to the Office of the United States Trade Representative ("USTR") a White Paper entitled *Competition Issues in the Australian Telecommunications Market* (the "September 2001 White Paper"). The purpose of this White Paper was to provide the USTR a background of Australia's telecommunications market and regulatory environment, as well as to bring to the USTR's attention the substantial barriers to market entry and participation faced by U.S. telecommunications companies seeking to do business in Australia.

Pursuant to the request of USTR staff, we hereby provide the USTR with an update of significant developments and events in the Australian telecommunications market which occurred after the September 2001 White Paper was originally submitted. We understand that the date has passed for officially submitting comments for the USTR's Review of Compliance with Telecommunications Trade Agreement pursuant to Section 1377 of the Omnibus Trade and Competitiveness Act of 1988 ("Section 1377 Review"),[1] however, to the extent possible, we ask the USTR to consider the attached September 2001 White Paper and this update during its Section 1377 Review. We also encourage the USTR to continue to raise these competition issues with the Australian government whenever appropriate.

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[1] / 66 Fed. Reg. 248 (Dec. 27, 2001).

I. BACKGROUND

A. Market Overview

Australia liberalized its telecommunications market in 1997 with the enactment of the Telecommunications Act 1997 and the addition of two telecommunications-specific parts to the Trade Practices Act 1974. Regulation of the telecommunications market is divided between the Australian Communications Authority ("ACA"), which is responsible for carrier licensing, service performance and quality, technical standards, universal service obligations and spectrum management, and the Australian Competition and Consumer Commission ("ACCC"), which regulates telecommunications competition issues, including anti-competitive practices and the administration of Australia's telecommunications access regime. The latter function gives the ACCC responsibility for interconnection and access issues (including local loop unbundling) and for arbitrating access-related disputes. The ACCC also has the power to establish price controls on telecommunications services and to develop and implement record-keeping and reporting obligations.

The Department of Communications, Information Technology and the Arts ("DCITA") is the primary agency responsible for developing telecommunications policy and introducing telecommunications legislation. The DCITA (together with the Department of Finance and Administration) administers the Australian government's majority shareholding of Telstra, and the Minister who heads the DCITA (currently, Senator Richard Alston) also serves as Parliament's Minister for Telstra and as the voting shareholder on behalf of the Australian Commonwealth.

The Australian telecommunications market remains dominated by incumbent operator Telstra, which is 50.1% owned by the Government of Australia. Telstra owns or controls nearly all of Australia's fixed-line infrastructure, including over 95% of the country's local access lines, and is Australia's largest mobile operator with over 42% of the Australian mobile market. Not only does Telstra continue to have a near stranglehold on the Australian telecommunications market, but, as outlined below, Australia's policies and regulatory framework have thus far been inadequate to fully open the market to effective competition.

B. Barriers to Market Entry

The September 2001 White Paper describes in detail how Australia's current telecommunications regulatory environment has created – and even exacerbated – numerous regulatory and economic barriers to market entry and the development of effective competition and how several aspects of Australia's regulatory regime contravene its WTO commitments.

In summary, these problems include:

- The inability of Australian regulators to curb anti-competitive behavior by dominant incumbent Telstra, such as
  - delaying or denying access to its legacy network;

- charging wholesale rates far in excess of its costs;
- bundling competitive and monopoly services;
- exploiting its position to gain unfair leverage in negotiations;
- refusing to enter into peering arrangements for ISP traffic;
- imposing unnecessary and time-consuming technical certification requirements.

- The inability of Australian regulators to resolve disputes concerning interconnection with Telstra (some of which have been pending since 1997 and remain unresolved);

- The inability of Australia's regulators to establish rates for network access and interconnection that are *final* and *cost-based*;

- Telstra wholesale local loop access rates that are substantially higher than Telstra's retail end-user rates for local access;

- Telstra fixed-to-mobile wholesale rates for terminating calls on Telstra's mobile network that greatly exceed the rates Telstra charges to its own retail fixed-line customers;

- Australia's refusal to require line sharing;

- The lack of a Reference Interconnection Offer for Telstra, access to any of Telstra's existing interconnection agreements, or any clear and coherent guidance concerning interconnection and network access;

- A dysfunctional dispute resolution and appeals process that is unduly burdensome, time-consuming, expensive, and creates additional regulatory and market uncertainty; and

- The lack of a truly independent regulator in an environment where the incumbent is still majority-owned by the government.

As a result of Australia's failure to meet its WTO commitments, competitive telecommunications carriers, including several with substantial U.S. investment, have been seriously impeded in their ability to compete in the Australian market. As discussed below, some of these issues have been at least partially addressed by the Australian government since the September 2001 White Paper was originally submitted. Nevertheless, significant progress is still required before Australia can be considered in compliance with its WTO obligations to introduce open and effective competition in the Australian telecommunications market.

II. RECENT DEVELOPMENTS IN AUSTRALIA

Since the original submission of the September 2001 White Paper, Australia has taken some important, positive steps towards lifting some of its barriers to market entry.

These include major reforms of its dispute resolution regime, the launch of a competition investigation into Telstra's provisioning of wholesale ADSL services, an inquiry into the possible introduction of line sharing, and efforts to increase regulatory and market transparency. In addition, Australia's Productivity Commission conducted an intensive investigation into regulation of the Australian telecommunications market and, on December 21, 2001, issued a detailed report including proposals for regulatory reform. These developments are discussed below.

A. Dispute Resolution Reform

One of the most significant problems discussed in the September 2001 White Paper is Australia's dispute resolution regime.

In becoming a signatory to the WTO Basic Telecommunications Agreement and the related Reference Paper, Australia specified that terms and conditions of access will be established primarily through processes of commercial negotiation or by reference to access undertakings given by access providers which may draw upon an industry code of practice approved by the independent regulator.[2] Australia also stated that an independent arbitrator will make a decision based on transparent criteria to ensure that rates are fair and reasonable, and will resolve disputes about relevant costs.

The ACCC fulfils the role of the independent arbitrator required under Australia's WTO commitments, with responsibilities that include arbitration of access and interconnection disputes, approval of standard offers, and pricing and cost issues concerning declared services. [3] This is in addition to the ACCC's responsibilities and powers to monitor and enforce competition regulations, including tariff and record-keeping requirements.[4] As a practical matter, however, the scope of access and interconnection issues which may be brought before the ACCC for arbitration is limited to the provision of declared services, since all non-declared services are considered by Australia to be subject strictly to commercial negotiation between the parties. Unlike in the United States or in Europe, where arbitrations and dispute resolution proceedings carried out by state or national regulatory authorities are subject to strict timelines, ACCC arbitration proceedings can continue for months or even years before a final decision is issued. The costs to operators of taking part in such lengthy proceedings are very high, in terms of both time and resources, and have proven prohibitively expensive for many new entrants. Many of the problems competitive carriers and service providers have encountered in dispute resolution have been a result of Telstra's ability to manipulate the arbitration and appeals process to prolong resolution of these cases indefinitely.

As a result of these problems, in the Fall of 2001 Australia adopted major reforms to its telecommunications dispute resolution procedures with the enactment of the Trade Practices Amendment (Telecommunications) Act 2001 (the "2001 Amendment").

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[2] / Australia: Schedule of Specific Commitments, GATS/SC/6/Suppl. 3, April 11, 1997 at page 6.

[3] / Trade Practices Act, Part XIC, Division 3.

[4] / Trade Practices Act, Part XIB.

Prior to these reforms, an arbitration in Australia was a private – rather than public – proceeding before the ACCC. Both the ACCC's arbitration proceedings and the decisions themselves were strictly confidential and could not be disclosed to anyone other than the individual parties to the dispute. Parties breaching the confidentiality of arbitrations were subject to penalties that included fines and/or imprisonment. The results of an arbitration applied only to the individual parties, and the full text of the determination, including the arguments set forth and the reasoning behind the ACCC's decision, were available only to the individual parties and were also covered by the confidentiality rules. Because competitive operators had no way of discovering how the ACCC had ruled in previous disputes over similar issues, they were essentially required to re-litigate these issues from scratch and risk wasting both time and resources in deciding whether to litigate issues that may have already been decided.

Under the 2001 Amendment, the ACCC will now be empowered to conduct multilateral arbitrations, thus allowing several operators with similar issues to join together in a single proceeding. In addition, the ACCC will be permitted to publish both the results and reasoning of interim and final arbitration decisions – thus removing the cloak of confidentiality – and will also be allowed to use information gathered during an arbitration proceeding in subsequent proceedings. These measures are expected to encourage new market entry and effective competition by substantially lowering arbitration costs and greatly increasing both regulatory and market certainty. They also are expected to provide a more level playing field for commercial negotiations.

The 2001 Amendment also streamlines the arbitration process by allowing arbitrations to be conducted by a single ACCC Commissioner (rather than by at least two Commissioners, as currently required) in order to increase efficiency and by limiting opportunities for operators to engage in "strategic abuse" of the arbitration system in order to gain leverage in negotiations (for example, the ACCC can now backdate the effective date of arbitration decisions to the date of commencement of negotiations between the parties, rather than to the date of notification of the dispute to the ACCC). The new rules also allow pending disputes to be withdrawn only with the consent of either both parties or of the ACCC, thus eliminating the stratagem of notifying a dispute, forcing the other side to go through a long and costly arbitration, and then withdrawing the dispute immediately prior to the issuance of a final determination.

Once the ACCC makes a decision, whether in an arbitration or in any other proceeding, its decision may be appealed to the Australian Competition Tribunal (the "ACT").[5] As with the ACCC, the ACT hears disputes arising from all sectors of the Australian economy, not just telecommunications. An appeal to the ACT can add significantly to the cost and delay of obtaining a final resolution. The 2001 Amendment attempts to address the problem of delays and uncertainty caused by these appeals. Under the previous system, the ACT not only reviewed all aspects of the record of the arbitration or other proceeding, but would also accept new evidence and arguments not previously addressed by the ACCC, thus making the ACT review effectively a re-

[5] / *See, e.g.*, Trade Practices Act, Part XIB, Division 10.

arbitration of the dispute. As a result, the ACT appeals process alone could take up to two or more years. The 2001 Amendment limits the scope of evidence that the ACT may consider in reviewing an ACCC arbitration decision to "that which was available to the ACCC in making the determination," although evidence that had been deliberately withheld from the ACCC may still be introduced. This is expected to significantly reduce the time it takes for the ACT to carry out its review and issue its decision.

Decisions from the ACT may be appealed to Australia's federal courts. Telstra frequently used this process to obtain stays of unfavorable decisions and further delay the enforcement of a regulatory order or arbitration decision. Under the 2001 Amendment, however, any party receiving an unfavorable decision from the ACT will *not* be able to have that decision (or decisions by the ACCC) stayed while appeals are pending before the federal courts.

These recent amendments to the Trade Practices Act have brought about significant, meaningful reform of Australia's telecommunications dispute resolution process and should be of great help in improving the competitive environment of Australia's telecommunications market. The Australian government should also be applauded for the speed with which these reforms were enacted.

However, the reformed dispute resolution process has yet to be tested in practice, so it is still too soon to determine the practical effectiveness of the reforms. In addition, the reforms have still left several major problems unaddressed. First, there is still no mandatory deadline or timeframe for the ACCC to hear and resolve access disputes, thus leaving the process still vulnerable to delaying tactics by the incumbent. Second, the cost of bringing an access dispute before the ACCC for resolution remains high and, absent any procedural deadlines, still has the potential to escalate well beyond a competitive provider's means. Together, these factors will continue to operate as a deterrent to the filing of legitimate disputes by competitive providers, thus allowing Telstra to maintain its unfair leverage in interconnection negotiations and maintaining a barrier to new market entry and the development of effective competition.

The DCITA recognizes that, even with these reforms, problems with Australia's dispute resolution process remain. As Senator Richard Alston, Australia's Minister for Communications, Information Technology and the Arts, stated in a speech given to the Australian Telecommunications Users' Group in March 2002:

> "The Government does not accept that the existence of only three remaining arbitrations before the ACCC is evidence of a perfectly working market. We understand that many access seekers took the certainty provided by accepting the offer on the table rather than risking a protracted dispute before the ACCC and possibly the ACT and the Federal Court and the High Court. . .Lawyers like to say that justice delayed is justice denied. A regulatory regime that allows incumbents to game the system in order to bring smaller

competitors to their knees is certainly not justice – or good for consumers."[6]

The USTR should actively support the DCITA in its efforts to continue reforming Australia's dispute resolution process and regulatory framework and ensure that the problems identified are addressed.

B. Competition Investigation of Telstra's ADSL Services

Telstra's near-total monopoly on local access infrastructure and the unavailability of line sharing in Australia have made all competitive service providers entirely dependent on Telstra's wholesale ADSL services in order to provide their own broadband services to customers. However, Telstra's prices for wholesale ADSL were so high that it was impossible for other service providers to compete with Telstra's retail prices. In addition, Telstra implemented an overly-complex network configuration and architecture for its wholesale ADSL services that effectively thwarted competitive access.

The ACCC initiated a competition investigation and issued a Part A Competition Notice to Telstra in September 2001 after determining that Telstra was indeed engaging in anti-competitive conduct in the provision of its wholesale ADSL services to its competitors.[7] Telstra was given until November 30, 2001, to make the changes and improvements necessary to address the ACCC's concerns. Just *one week* before the Competition Notice deadline, Telstra announced significant price reductions of up to 30% for its "Flexstream" wholesale ADSL product for large wholesale customers, such as carriers and large ISPs ("Flexstream" has approximately 40 customers). Telstra also made new commitments to the ACCC to improve its provisioning of and access to these services. In response, the ACCC kept the Competition Notice in effect, but extended the deadline for Telstra to implement its service improvements to March 15, 2002.[8]

On March 8, 2002, Telstra announced that it was significantly cutting its prices for its "ISPConnect" wholesale ADSL product for smaller ISPs as well. While Telstra has said that the price reduction for "ISPConnect" was for commercial reasons rather than as a result of regulatory pressure, [9] it should be noted that it was made exactly one week before the March 15, 2002, deadline of the ACCC's Competition Notice.

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[6] / *Speech to ATUG 2002 Conference by Senator the Hon. Richard Alston, Minister for Communications, Information Technology and the Arts*, March 2002 (available online at http://www.dcita.gov.au) (hereinafter: "*Sen. Alston Speech*").

[7] / ACCC Media Release MR 214/01, *ACCC Believes Telstra Holding back Competition for High Speed Internet to The Home*, September 7, 2001.

[8] / ACCC Media Release MR 297/01, *Telstra's Wholesale ADSL Prices Falling, But ACCC to Maintain Watch Over Competition for High Speed Internet Services*, November 30, 2001.

[9] / *Telstra Cuts Wholesale ADSL Prices In Half*, Total Telecom, March 11, 2002 (available online at http://www.totaltele.com).

While the ACCC deserves credit for its action against Telstra, this proceeding also illustrates the limits of Australia's regulatory regime. Telstra was able to take full advantage of the generous deadline provided by the ACCC's Competition Notice of September 2001 to delay taking *any* action to correct its anti-competitive behavior. Once Telstra finally did take action to comply, it only complied in part by reducing prices (and even then, only for its largest customers), yet was successful in delaying any further action for at least an additional four months. Meanwhile, Telstra is able to use this delay to continue its anti-competitive practices and continue increasing its strength and position in the provision of broadband services in Australia.[10]

C. Line Sharing

In November 2001, Telstra began line sharing technical trials in Sydney and Melbourne, with company-specific trials scheduled to run between February and June 2002. Telstra has announced that it intends to offer line sharing exclusively as a wholesale product, and may start making it available to competitors as soon as the second quarter of 2002. The ACCC also is conducting an inquiry into whether to make line sharing a "declared service," meaning that Telstra and all other access services providers would be required to provide it. (If line sharing becomes a declared service, the ACCC will have the power to arbitrate line sharing negotiations and disputes.) The ACCC planned to have its report and recommendations ready by February 2002, however these have not yet been released.

The decision by both Telstra and the Australian government to finally consider allowing line sharing is a welcome, yet long overdue development. Line sharing is both an effective and cost-efficient means to introduce and establish competition in the provision of broadband services and remove several significant barriers to market entry. However, Australia's recent history on the issue of line sharing (previously, the Australian government accepted without serious question Telstra's assertion that it was "technically impossible") demonstrates a clear danger of delays and foot-dragging before a true line sharing product becomes available to competitors. Without line sharing, competitive providers have as their only option Telstra's wholesale ADSL product, which, as discussed in the preceding section, is not yet a viable alternative. Delays in the introduction and implementation of line sharing serve only to further entrench Telstra's dominant position to the detriment of competition, thus raising the market entry barriers even higher.

Senator Richard Alston, Australia's Minister for Communications, Information Technology and the Arts, stated in a speech given to the Australian Telecommunications Users' Group in March 2002 that "it is important that issues surrounding ULL and line sharing are addressed as a matter of priority to ensure that these services are readily available to support broadband deployment."[11]

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[10]/ Telstra's ADSL services can currently be accessed by approximately 65% of the Australian population. In addition, Telstra has 50% ownership of cable provider Foxtel, another major provider of broadband services. (*See Sen. Alston Speech*, March 2002).

[11]/ *Sen. Alston Speech*, March 2002.

The USTR should support Senator Alston and urge the Australian government to press forward with the implementation of line sharing at once. The continuing delays in the implementation of line sharing are stalling competition and the development and deployment of competitive broadband service in Australia.

D. ISDN Access

Another problem highlighted in the White Paper – ISDN access – has been partially addressed by the ACA's decision on March 4, 2002, to require Telstra to provide carrier pre-selection for ISDN-originated traffic. The ACA has ordered Telstra to begin providing carrier pre-selection on its "OnRamp 2 Indial" ISDN product by April 30, 2002 and on its "OnRamp 30" ISDN product by July 15, 2002. These extended deadlines were set after Telstra applied to the ACA for a temporary extension to allow time for "the necessary changes to be made to [Telstra's] systems."[12] Because ISDN is the preferred access method for business customers in Australia, the lack of carrier pre-selection has placed Telstra's competitors at a severe disadvantage in the business access market.

While this decision is certainly a welcome step, it is also very late in coming. Further, there is no assurance that Telstra will indeed meet its deadline for making "the necessary changes" to its systems – changes that could have and should have been mandated long before. Although the ACA is requiring Telstra to provide progress reports on a fortnightly basis on the implementation of ISDN pre-selection, there is no indication of what, if any, penalties may be incurred if Telstra misses these deadlines.

Other problems concerning ISDN access remain. Specifically, Telstra offers a flat rate ISDN data access product on a retail basis, but refuses to offer a corresponding wholesale product, thus making it effectively impossible for other providers to compete with Telstra in the provision of ISDN data access.

E. Transparency and Reporting Obligations

In addition to the dispute resolution reforms discussed above, Australia has also taken a positive step towards regulatory and market transparency with its recent proposal to publicly disclose certain information provided by major Australian carriers pursuant to the ACCC's record-keeping and reporting rules.

Under these rules, carriers and service providers are required to file regular financial accounting reports only if the ACCC provides them with notice specifying them by name. These carriers must provide their reports in accordance with the Telecommunications Regulatory Accounting Framework ("RAF"), which specifies what records and data are to be provided. In general, this includes, for each service listed in the RAF schedule, statements showing: (i) capital adjusted profit and loss; (ii) capital employed; (iii) fixed assets; and (iv) allocation of costs, revenue and capital employed. The RAF also requires reports on their weighted average cost of capital and service

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[12]/ ACA Media Release No. 9, *Pre-selection to be Available Soon on Specific Telstra OnRamp Products*, March 4, 2002.

usage. Currently, the ACCC requires reports only from Australia's most significant carriers: Telstra, Optus, Vodafone, AAPT and Primus. Telstra and Optus (the former duopoly operators prior to market liberalization in 1997) are required to report fully under the RAF record-keeping regime, while Vodafone, AAPT and Primus need only meet some of the provisions.

Currently, the information collected by the ACCC pursuant to the record-keeping rules is treated as confidential. However, on January 21, 2002, the ACCC announced a proposal to publicly disclose some of this information in order to improve transparency and reduce "the information asymmetry between an access provider (commonly Telstra) and access seekers."[13] Information that the ACCC is proposing to publicly disclose includes some of Telstra's local loop cost data. The ACCC expects that the regular release of such information will reduce the number of disputes between telecommunications companies, "promote a better informed market and improve the operation of the regulatory process."[14]

Regulatory initiatives such as this are the type that must be supported and encouraged by the USTR.

F. Productivity Commission Report and Proposals

Australia's Productivity Commission conducted an inquiry into telecommunications competition regulation and released its final report on December 21, 2001.[15] The report contains several proposals for reforming the telecommunications regulatory framework to foster new market entry and a competitive telecommunications market, and the Productivity Commission is now involved in a series of meetings with Australian legislators. These meetings are expected to result in new legislative reform proposals later this year, however further details are not currently available.

The USTR should seek to engage the Australian government in dialogue concerning these proposals, both to encourage their development and implementation and to ensure that they result in meaningful pro-competitive reforms.

III. ISSUES TO BE ADDRESSED

While there have been many significant developments in the Australian telecommunications market over the past year, many of the issues raised in the September 2001 White Paper have yet to be addressed. These include: (i) the continuing ineffectiveness of competition restraints on Telstra; (ii) wholesale rates charged by Telstra that far exceed its costs; (iii) wholesale local loop access rates that are substantially higher than Telstra's retail end-user local access rates; (iv) Telstra's anti-

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[13] / ACCC Media Release MR 7/02, *ACCC Proposes Release of Regulatory Accounting Information*, January 21, 2002.

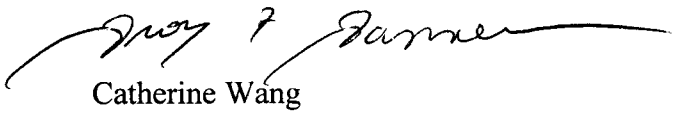
[14] / *Id.*

[15] / The report is available at http://www.pc.gov.au/inquiry/telecommunications/finalreport/index.html

competitive practices concerning interconnection, peering and unnecessary technical certification requirements; (v) Telstra's discriminatory and anti-competitive fixed-to-mobile termination pricing scheme; (vi) the lack of a Reference Interconnection Offer for Telstra, clear interconnection procedures or established rates for network access that are final and cost-based; and (vii) the Australian government's continued majority ownership of Telstra and the lack of a truly independent regulator.

The recent comments by Senator Richard Alston (cited above) and the results of the Productivity Commission's report demonstrate that Australia has recognized some, if not all, of the competition problems in its current telecommunications market and that certain parts of the government are prepared to take action to address these issues. However, their efforts will require broad-based support in order for any real or meaningful progress to occur. This represents an ideal environment for the USTR to engage the Australian government in efforts to address the competitive concerns discussed in the White Paper and in this accompanying letter.

Respectfully submitted,



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